

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
Land Division
Honolulu, Hawaii 96813

April 8, 2016

Board of Land and Natural Resources
State of Hawaii
Honolulu, Hawaii

Hawaii

Approve Mediated Settlement of Rent Disputes Relating to Ten-Year Extensions of General Lease Nos. S-3592, S-3609, and S-3611, located in Hilo, Hawaii, TMK Nos. (3) 2-2-032:067,078, (3) 2-2-032:068,070, and (3) 2-2-032:021.

APPLICANTS:

Hawaii Planing Mill, Ltd. (HPM) and Land Division, Department of Land and Natural Resources.

LEGAL REFERENCE:

Section 171-17, Hawaii Revised Statutes, as amended.

LOCATION AND AREA:

Lessee HPM conducts a business, HPM Building Supply, that straddles the premises of all three state leases. The lands are as follows:

GL S-3592: Parcel III (Lots 6 and 15), Waiakea Business and Industrial Lots situated at Waiakea, South Hilo, Hawaii, 0.778 acre, identified by Tax Map Key: (3) 2-2-032:067,078.

GL S-3609: Parcel II (Lots 5, 10, 11, 12, 13 and 14), Waiakea Business and Industrial Lots situated at Waiakea, South Hilo, Hawaii, 2.363 acres, identified by Tax Map Key: (3) 2-2-032:068,070.

GL S-3611: Parcel IV (Lots 7, 8, 9, 16, 17 and 18), Waiakea Business and Industrial Lots situated in Waiakea, South Hilo, 2.334 acres, identified by Tax Map Key: (3) 2-2-032:021.

Attached as Exhibit A are the survey maps from the leases.

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

DHHL 30% entitlement lands pursuant to the Hawaii State Constitution: No

CHARACTER OF USE:

GL S-3592 Original use: For the first 5 years, the same business use in which the lessee was engaged at the time of the natural disaster (transportation); provided that the lessee may use the premises for other than transportation purposes with the prior written consent of the Board. At the Board's meeting on October 24, 2014, under agenda item D-4, the Board approved an amendment to change the character of use to "uses allowed under the current County of Hawaii Zoning Code, ML-20, limited industrial."

GL S-3609 Original use: For the first 5 years, the same business use in which the lessee was engaged at the time of the natural disaster (operation of fleet of cars for tourist sightseeing services); provided that the lessee may use the premises for other than transportation purposes with the prior written consent of the Board. At the Board's meeting on October 24, 2014, under agenda item D-5, the Board approved an amendment to change the character of use to "uses allowed under the current County of Hawaii Zoning Code, ML-20, limited industrial."

GL S-3611 Original use: For the first 5 years, the same business use in which the lessee was engaged at the time of the natural disaster (wholesale-retail/building materials); provided that the lessee may use the premises for other than wholesale-retail/building materials purposes with the prior written consent of the Board. At the Board's meeting on October 24, 2014, under agenda item D-6, the Board approved an amendment to change the character of use to "uses allowed under the current County of Hawaii Zoning Code, ML-20, limited industrial."

TERM OF LEASE:

The rental dispute relates to a ten-year extension of the leases from January 16, 2016 through January 15, 2026, bringing each lease term to 65 years.

ANNUAL RENTAL:

The settlement, which is subject to Board approval, is embodied in a Settlement Agreement attached to this submittal as Exhibit B. The parties agreed to the following ground rent per annum for each lease for the ten-year extension beginning January 1, 2016:

Lease No.	1/16/2016 to 1/15/2021	1/16/2021 to 1/15/2026
S-3592	\$32,825	\$33,666
S-3609	\$74,402	\$76,310
S-3611	\$78,779	\$80,799
Totals	<u>\$186,006</u>	<u>\$190,775</u>

The parties agreed that the agreed upon rental amounts are not an agreement as to fair market rent but is a settlement of a dispute falling within the range of fair market rent opinions of the department's appraiser and HPM's appraiser.

DCCA VERIFICATION:

Place of business registration confirmed: YES X NO
Registered business name confirmed: YES X NO
Good standing confirmed: YES X NO

REMARKS:

HPM was not the original lessee of GL S-3592, but the lease was assigned to HPM with the consent of the Board dated April 7, 1987.

HPM was not the original lessee of GL S-3609, but the lease was assigned to HPM with the consent of the Board dated October 5, 1988.

HPM was the original lessee of GL S-3611, but over its history there were a number of assignments of interests in the lease. At the Board's meeting of August 14, 2015, under agenda item D-2, the Board consented to an assignment of a 20% interest in the lease to HPM, which held a 60% interest in the lease before the assignment.

At the Board's meeting of October 24, 2014, under agenda items D-4, D-5, and D-6, the Board approved a ten-year extension for each lease commencing on January 16, 2016, and expiring on January 15, 2026, under certain terms and conditions, including but not limited to a rental reopening for the extension period.

An appraisal of rental values for the three leases was completed by DLNR's appraiser. HPM did not agree with the appraised values and had its own appraiser prepare appraisal reports. The two appraisers were wide apart on the rental values. DLNR's appraiser did not agree with HPM's appraiser's rental values.

Disputes in rent reopenings for leases of public lands are governed by Hawaii Revised Statutes (HRS), section 171-17, as amended. Prior to July 1, 2014, rent disputes were generally arbitrated by a three-member arbitration panel. However, the Legislature amended HRS section 171-17 effective as of July 1, 2014 to require non-binding mediation by a single mediator prior to undergoing binding arbitration.¹

Section 171-17(d), HRS, states in part: "If the board's and the lessee's appraisers do not agree upon the lease rental, the lessee and the board shall in good faith attempt to resolve the dispute by nonbinding mediation by a single mediator mutually agreed upon by the parties." This resolution is in effect a settlement of the dispute because the mediation is nonbinding and both parties, department and lessee, have to agree on the rent, as opposed to an arbitration of rent determined by a third party that is final and binding on the parties. In mediation, the parties take many considerations into account, including the cost of an arbitration with one arbitrator if mediation fails.

The parties agreed to have real estate appraiser Esther Price serve as the mediator. Mediation between the parties was conducted on February 24, 2016 in Honolulu. Participants in the mediation were Michael K. Fujimoto, Chairman, President, and Chief Executive Officer of HPM; Adam Bauer, Chief Financial Officer and Hilo Branch Manager of HPM; and HPM's legal counsel Francis L. Jung, Esq. Participants from the department were Russell Tsuji, Land Division Administrator, and Pamela Matsukawa, Appraisal and Real Estate Specialist, with Deputy Attorney General Cindy Young as the department's attorney.

At the start of the mediation process, the parties agreed that the mediation would be treated as confidential under Rule 408 of the Hawaii Rules of Evidence. In other words, the parties had agreed to confidentiality during mediation to allow for candor and flexibility and in the event mediation was not successful and arbitration proceedings had to be conducted. Therefore, the details of the mediation discussions are not set forth in this submittal. If any board member has any questions on the issues addressed during mediation, staff will ask the deputy attorney general to contact the board member directly.

However, HPM has specifically agreed that certain matters addressed in mediation may be disclosed.

As stated in the Settlement Agreement (Exhibit B), the parties agreed to the ground rent per annum for each lease for the ten-year term beginning January 1, 2016, including a step-up for the second five years. The parties agreed that, to the extent section 171-17(d), HRS, allows for the settlement of the rent dispute by mediation, the agreed upon ground rents are not the parties' positions on fair market rent but are the result of the department's consideration of HPM's significant financial hardship (losses) from 2008 to 2013, as

¹ Additionally, under the amended law, arbitrations are now submitted to a single arbitrator for determination, rather than to a three-member panel. The amending act is Act 168, Session Laws of Hawaii 2014.

shown by HPM's audited financial statements for 2007 to 2014. DLNR also considered that HPM's business is 95 years old and is 100% employee owned. As this was a settlement of a rental dispute for a single business operation spanning the properties of all three leases, the total rent for all three leases each year was first determined and then allocated among the three leases. Nevertheless, the agreed upon rents are higher than the HPM appraiser's values and fall between the fair market rent opinions of DLNR's appraiser on the higher end and HPM's appraiser on the lower end.

The appraisers' opinions of rental values are as follows:

<u>GL No.</u>	<u>DLNR Appraiser's Rental Value</u>	<u>HPM Appraiser's Rent Value</u>
S-3592	\$ 34,560/yr.	\$30,000/yr.
S-3609	\$105,000/yr.	\$68,000/yr.
S-3611	\$103,680/yr.	\$72,000/yr.

The following are the rents prior to the ten-year extension:

<u>GL No.</u>	<u>Rent</u>
S-3592	\$27,100/yr.
S-3609	\$71,000/yr.
S-3611	\$74,000/yr.

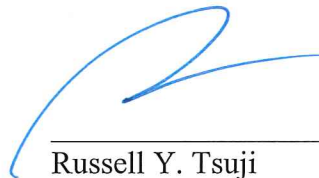
The following are the agreed upon annual ground rents that are subject to the Board's approval:

<u>Lease No.</u>	<u>1/16/2016 to 1/15/2021</u>	<u>1/16/2021 to 1/15/2026</u>
S-3592	\$32,825	\$33,666
S-3609	\$74,402	\$76,310
S-3611	\$78,779	\$80,799
Totals	<u>\$186,006</u>	<u>\$190,775</u>

RECOMMENDATION:

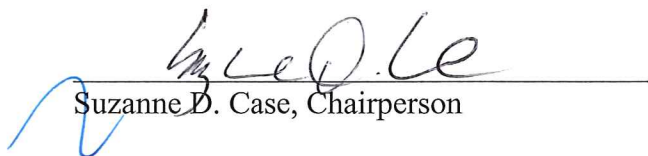
That the Board approve the mediated settlement of annual ground rents for General Leases S-3592, S-3609, and S-3611, as set forth above, for the ten-year extension period of each lease.

Respectfully Submitted,



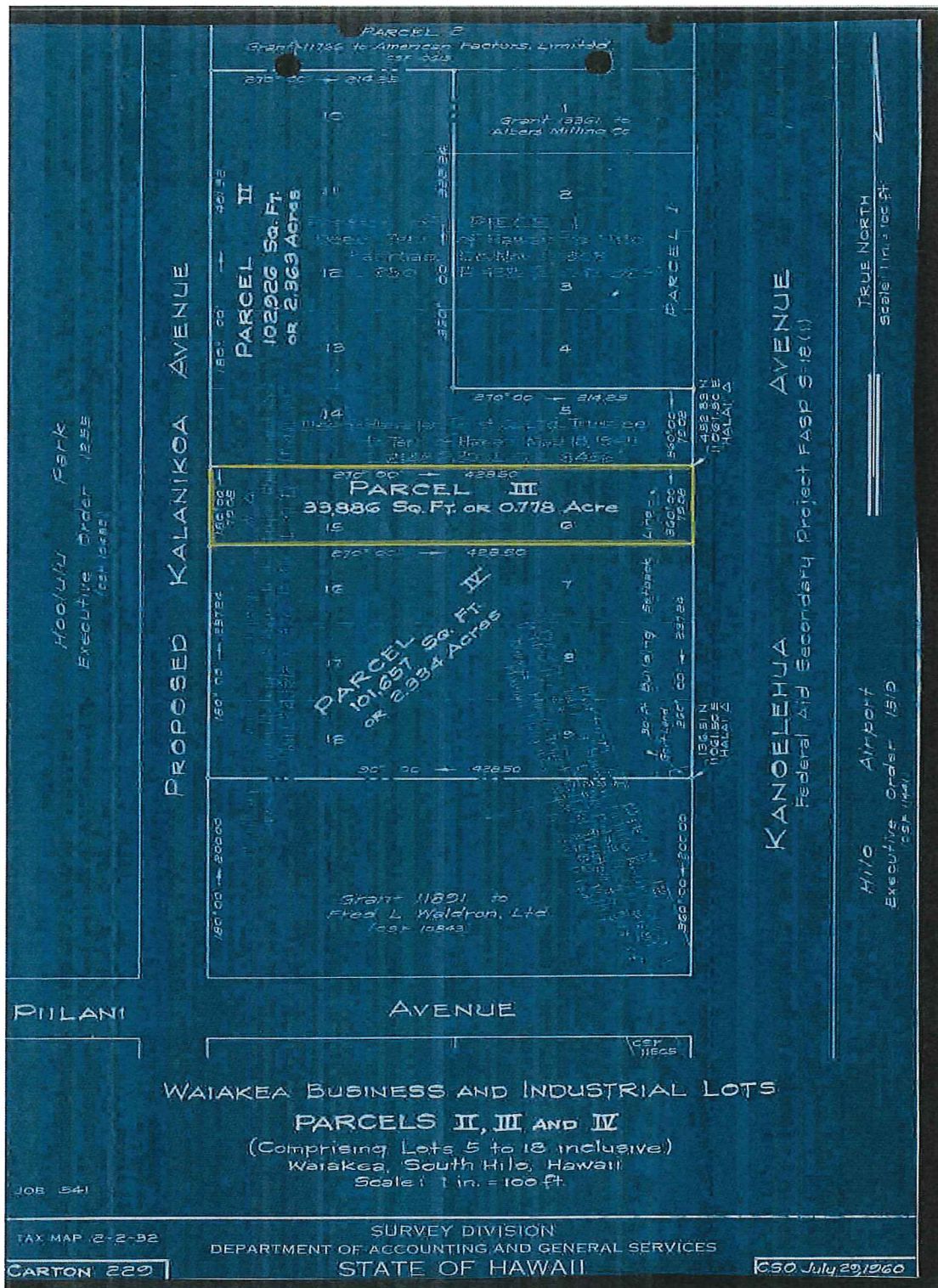
Russell Y. Tsuji
Land Division Administrator

APPROVED FOR SUBMITTAL:

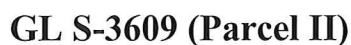


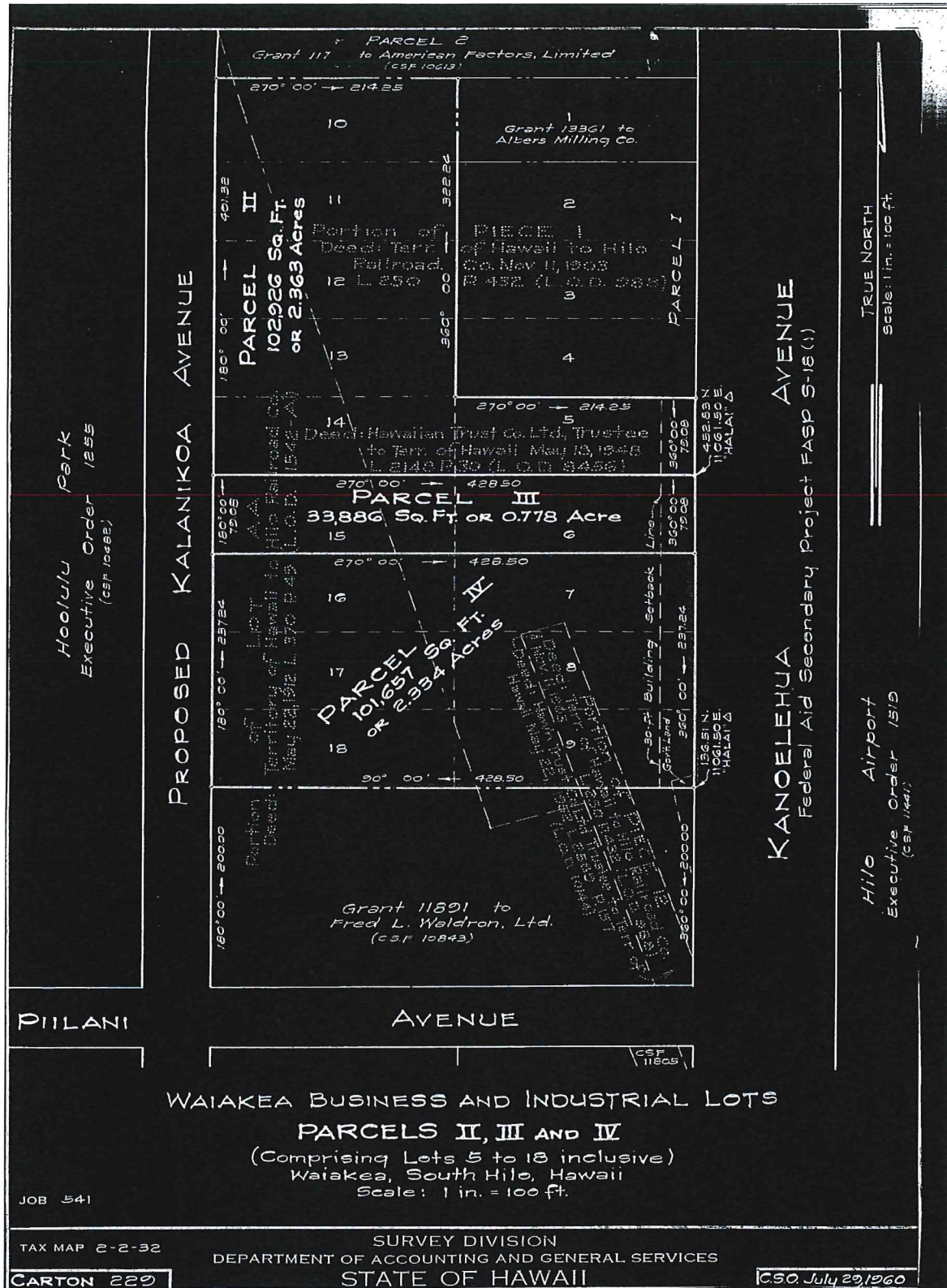
Suzanne D. Case, Chairperson

EXHIBIT A



GL S-3592 (Parcel III)





GL S-3611 (Parcel IV)

March 2, 2016

Russell Y. Tsuji
Land Division Administrator
State of Hawaii
Department of Land and Natural Resources
Land Division
P.O. Box 621
Honolulu, Hawaii 96809

Francis L. Jung, Esq.
Jung & Vassar, P.C.
Attorneys at Law
A Law Corporation
Kuakini Tower, Suite 100
75-5722 Kuakini Highway
Kailua-Kona, Hawaii 96740

Re: **MEDIATION SETTLEMENT AGREEMENT**
State of Hawaii General Lease Nos.
S-3592, S-3609 and S-3611
Kanoelehua and Kalanikoa Avenues
Hilo, Hawaii 96720

PARTIES

The State of Hawaii Department of Land and Natural Resources is the Lessor and Hawaii Planning Mill, Ltd. is the Lessee under the above-referenced leases. The Lessor and Lessee, within the body of this document, are respectively referred to as "DLNR" and "HPM" and in plural as "Parties".

LEASE DESCRIPTIONS

The individual leases are summarized, by lease number, tax map key parcel numbers, street addresses, and land areas in the following schedule:

Exhibit B

Lease No.	Tax Map Key 3 rd Division	Street Address	Land Area (Sq. Ft.)
S-3592	2-2-32-67	Kalanikoa Avenue	16,943
	2-2-32-78	352 Kanoelehua Avenue	<u>16,943</u>
Total			33,886
S-3609	2-2-32-68	336 Kanoelehua Avenue	50,529
	2-2-32-70	275 Kalanikoa Avenue	<u>52,097</u>
Total			102,926
S-3611	2-2-32-21	380 Kanoelehua Avenue	101,657

HPM conducts one business operation on the adjoining grounds of the three leases.

BACKGROUND INFORMATION

The leases initially commenced on January 16, 1961 and were scheduled for termination on January 15, 2016. Pursuant to Act 207, Session Laws of Hawaii 2011, the Lessee requested and was granted, on October 24, 2014, ten-year extensions by the Board of Land and Natural Resources of DLNR for all three leases. The extensions, which commenced on January 16, 2016 and end on January 15, 2026, increased the aggregate lease terms from 55 to 65 years.

DLNR and HPM independently commissioned appraisals of the ground rents for the ten-year term commencing January 16, 2016, and based on the market value estimates of the individually selected appraisers, the appraisers could not mutually agree on fair market rents for the next ten-year term of each lease. Notwithstanding this disagreement, the agreed rent mediated was higher than the Lessee's appraiser's value.

LEGAL REFERENCE

This mediation was conducted pursuant to Hawaii Revised Statutes (HRS) §171-17 subsection (d), which states, in part: "If the board's and the lessee's appraisers do not agree upon the lease rental, the lessee and the board shall in good faith attempt to resolve the dispute by nonbinding mediation by a single mediator mutually agreed upon by the parties".

MEDIATION SETTLEMENT

Ground rent for the three leases was conceptually but tentatively settled by mediation on February 24, 2016 subject only to the review and approval by the Board of Land and Natural Resources (BLNR) after a presentation by staff. The mediation was held at the CBRE office, located at 1003 Bishop Street, Suite 1800, Honolulu, Hawaii 96813. DLNR was represented by Russell Y. Tsuji, DLNR Land Division Administrator; Pamela K. Matsukawa, DLNR Appraisal and Real Estate Specialist; and Cindy Y. Young, Esq., Deputy Attorney General. HPM was represented by Michael K. Fujimoto, Chairman, President and Chief Executive Office; Adam Bauer, Chief Financial

Russell Y. Tsuji
Francis L. Jung, Esq.
March 2, 2016
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Officer and Hilo Branch Manager, and HPM's legal counsel, Francis L. Jung, Esq. Esther H.C. Price served as the mediator.

The Parties agreed to the following ground rent per annum for each lease for the ten-year term beginning January 1, 2016. The Parties agreed that, to the extent HRS §171-17(d) allows for the settlement of the rent dispute by mediation, the ground rents are not the parties' positions on fair market rent but are the result of DLNR's consideration of HPM's significant financial hardship (losses) from 2008 to 2013, as shown by HPM's audited financial statements for 2007 to 2014. DLNR also considered that HPM's business is 95 years old and is 100% employee owned. As this was a settlement of a rental dispute, the total rent for all three leases each year was determined and then allocated among the three leases.

Lease No.	1/16/2016 to 1/15/2021	1/16/2021 to 1/15/2026
S-3592	\$32,825	\$33,666
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S-3611	\$78,779	\$80,799
Totals	<u>\$186,006</u>	<u>\$190,775</u>

The ground rents shown were the result of a mediated settlement agreement by the parties and were not intended to be an agreement on fair market rental values.

ADDITIONAL AGREEMENTS

The Parties also mutually agree that, the mediated rents are subject to the BLNR's review and approval.

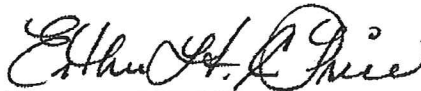
All promises, conduct and statements made in the course of reaching this Mediation Settlement Agreement are confidential and are governed by HRS §626, Hawaii Rules of Evidence, Rule 408 Compromise, offers to compromise and mediation proceedings. The Parties acknowledge that as a State agency, DLNR's files are generally public and the ground rents, when finally resolved, may be accessed by public request.

This agreement is binding on the signatories upon their signature. Both parties acknowledge that the Mediated Settlement Agreement will be presented to the State of Hawaii's Board of Land and Natural Resources for review and approval at its discretion.

By signing below, the Parties acknowledge they have read this agreement in its entirety, understand all the terms and conditions of the Agreement, and having done so, knowingly, voluntarily and freely enter into this Agreement without coercion or duress.

Russell Y. Tsuji
Francis L. Jung, Esq.
March 2, 2016
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It is understood that this Agreement may be executed in counterparts but it will have no force or effect unless and until executed by the mediator and authorized representatives of the Lessor and Lessee. The Parties and mediator will have each executed at least one but not necessarily the same counterparts. Russell Y. Tsuji will serve as the signatory for the Lessor, and Adam Bauer as the signatory for the Lessee.




Esther H.C. Price, MAI
Mediator

APPROVED AND ACCEPTED:

Lessor: STATE OF HAWAII
Department of Land & Natural Resources

By



Name: Russell Y. Tsuji
Title: Land Division Administrator

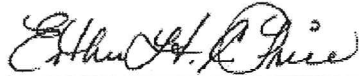
Lessee: HAWAII PLANNING MILL, LTD.

By

Name: Adam Bauer
Title: Chief Financial Officer and Hilo Branch Manager

Russell Y. Tsuji
Francis L. Jung, Esq.
March 2, 2016
Page 4

It is understood that this Agreement may be executed in counterparts but it will have no force or effect unless and until executed by the mediator and authorized representatives of the Lessor and Lessee. The Parties and mediator will have each executed at least one but not necessarily the same counterparts. Russell Y. Tsuji will serve as the signatory for the Lessor, and Adam Bauer as the signatory for the Lessee.




Esther H.C. Price, MAI
Mediator

APPROVED AND ACCEPTED:

Lessor: STATE OF HAWAII
Department of Land & Natural Resources

By _____
Name: Russell Y. Tsuji
Title: Land Division Administrator

Lessee: HAWAII PLANNING MILL, LTD.

By  _____
Name: Adam Bauer
Title: Chief Financial Officer and Hilo Branch Manager

Digitally signed by Adam Bauer
DN: cn=Adam Bauer, o=HPM
Building Supply, ou,
email=adam.bauer@hpmhawaii.com, c=US
Date: 2016.03.02 13:03:57 -10'00'